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IN THE
Supreme Court of the United States

OCTOBER TERM, 1940

NO. 578

E. W. GWINNER, Petitioner,

v.

D. B. HEINER, Formerly Collector of Internal Revenue.

**PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES CIRCUIT COURT OF
APPEALS FOR THE THIRD CIRCUIT.**

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**PETITION FOR A WRIT OF CERTIORARI TO THE
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E. W. Gwinner, petitioner above-named, by his attorneys, respectfully prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Third Circuit, entered in the above-entitled cause on September 9, 1940, reversing and affirming a decision of the District Court of the United States for the Western District of Pennsylvania.

Opinions Below.

The opinion of the District Court (R. 129-136) in the case of *E. W. Gwinner v. D. B. Heiner*, Formerly Collector of Internal Revenue for the Twenty-third Collection District of Pennsylvania, is reported in 25 Fed. Supp. 659. The opinion of the Circuit Court of Appeals (R. 145-150) is reported at 114 F. (2) 723 (Adv. Sheets).

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered on September 9, 1940. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code (28 U. S. C. § 347 (a), Mar. 3, 1891, c. 517, Sec. 6, 26 Stat. 828; Mar. 3, 1911, c. 231, Sec. 240, 36 Stat. 1157; Feb. 13, 1925, c. 229, Sec. 1, 43 Stat. 938).

Questions Presented.

1. Whether, in connection with a corporate reorganization, stock which was deposited subject to an escrow agreement which provided that the certificates were not to be delivered for a period of one year during which time the stock could not be sold or otherwise transferred by taxpayer, was actually received by taxpayer during the taxable year.

2. Whether stock received by a taxpayer in connection with a corporate reorganization, which stock was subject to a restrictive covenant that taxpayer could not sell the same for a period of one year after its receipt, had any fair market value for the purpose of determining the taxable gain realized by taxpayer under Section 112(c) (1) of the Revenue Act of 1928.

Statutes Involved.

Revenue Act of 1928, c. 852, 46 Stat. 816:

"SEC. 42. PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED.

"The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period."

"SEC. 111. DETERMINATION OF AMOUNT OF GAIN OR LOSS.

"(a) Computation of gain or loss.—Except as hereinafter provided in this section, the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the basis provided in section 113, and the loss shall be the excess of such basis over the amount realized.

* * * * *

"(c) Amount realized.—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.

"(d) Recognition of gain or loss.—In the case of a sale or exchange, the extent to which the gain or loss determined under this section shall be recognized for the purposes of this title, shall be determined under the provisions of section 112."

* * * * *

"SEC. 112. RECOGNITION OF GAIN OR LOSS.

"(a) General rule.—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

* * * * *

"(c) Gain from exchanges not solely in kind.—

(1) If an exchange would be within the provisions of subsection (b) (1), (2), (3), or (5) of this section if it were not for the fact that the property received in exchange consists not only of property permitted by such paragraph to be received without the recognition of gain, but also of other property or money,

then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property."

* * * * *

Statement of the Case.

E. W. Gwinner, petitioner herein, instituted an action against D. B. Heiner, formerly Collector of Internal Revenue, seeking to recover the sum of \$10,108.15 with interest thereon alleged to have been erroneously collected as income tax for the calendar year 1930.

Petitioner in 1930 was the owner of 625 shares of the stock of Duquesne Steel Foundry Company which he had acquired prior to March 1, 1913. On said date, the stock had a value of not less than \$127.50 per share. In a reorganization proceeding on June 16, 1930, of Duquesne Steel Foundry Company, Wheeling Mold & Foundry Company and Hubbard Steel Foundry Company, all of the assets of said companies were conveyed to Continental Roll & Steel Foundry Company, a new corporation. Under the plan of reorganization, plaintiff was entitled to receive for each share of stock of Duquesne Steel Foundry Company, \$96.33 in cash, three-fourths of a share of the preferred stock of Continental Roll & Steel Foundry Company and one and one-half shares of the common stock of said company. Under the agreements made in connection with said reorganization, petitioner did not actually receive said stocks of Continental Roll & Steel Foundry Company but it was held in escrow for him by a bank in Pittsburgh. The common and preferred stocks could not be sold for a period of one year from June 16, 1930, and the stock certificates were so stamped across the face thereof. Some time during the year 1930, the preferred stock was released to petitioner from the escrow agreement upon the express condition that it would not be sold prior to

June 15, 1931, without the consent of certain bankers and brokers who promoted the reorganization. Plaintiff, in his income tax return for the year 1930, returned said cash and stock received in the reorganization proceedings, showing a gain of \$50,362.50. He made a claim for refund on the ground that said amount had been erroneously returned and that the stock received under the restrictive agreement did not have a fair market value during the year 1930.

The case was tried by the Court (McVicar, J.) without a jury. The Court made special findings of fact and conclusions of law (R. 124-129, 25 Fed. Supp. 659), among which are the following:

Finding of Fact.

"8. The stock received by plaintiff by virtue of the restriction as to the sale thereof had no fair market value during the year 1930 and no fair market value thereof could be determined." (R. 126)

Conclusion of Law.

"I. The stock received by the plaintiff in 1930 in the reorganization proceedings was subject to a restrictive agreement so that its fair market value could not be determined during that year." (R. 128)

There was another issue involved in the case as heard by the District Court and as argued before the Circuit Court of Appeals but this other issue, which was decided by both Courts against petitioner, is not involved herein. Judgment was accordingly entered in favor of petitioner on November 28, 1938, by the District Court. An appeal was taken therefrom by defendant and the Circuit Court of Appeals reversed the decision of the District Court and held that the stock of Continental Roll & Steel Foundry Company received by petitioner in 1930 had a fair market value which could be determined during that year, notwithstanding the fact that it was subject to a restrictive agreement.

Specifications of Errors Intended to Be Urged.

The Circuit Court of Appeals erred (a) in reversing the decision of the District Court, (b) in failing to hold that petitioner did not receive the stock of Continental Roll & Steel Foundry Company in 1930, and (c) in holding that the stock of Continental Roll & Steel Foundry Company had a fair market value in 1930.

Reasons for Granting the Writ.

1. The Circuit Court of Appeals failed entirely to give any consideration to petitioner's contention that the stock of Continental Roll & Steel Foundry Company was not received by him in 1930 and therefore any gain realized by him with respect thereto could not be considered taxable income to him in that year. The District Court made no specific findings of fact with respect to this issue as it was not necessary for it to do so under its decision.

It is the contention of petitioner that the Circuit Court should have decided this issue for petitioner because, as a matter of law, petitioner had no right to receive the Continental stock in 1930. No findings of fact were necessary to reach this conclusion, but if the Circuit Court felt that it could not decide the issue on the basis of the facts as found by the District Court, then the proper procedure was to have sent the case back to the District Court with instructions to make specific findings on this issue.

The facts, however, are perfectly clear and they are not in dispute. Petitioner did not receive any stock of Continental Roll & Steel Foundry Company in 1930 as such stock was held in escrow until June 15, 1931. He had no rights whatsoever with respect to that stock as he could not sell, pledge or otherwise assign or transfer it, except a limited right in the case of the preferred

stock to pledge it. Under such circumstances no tax liability can arise on the theory petitioner received anything.

The fundamental basis of income taxation is the receipt by the taxpayer of some income. The entire structure of the income tax law is predicated upon this underlying conception. This is inherent in the very definition of income contained in Section 22 of the Revenue Act of 1928 as it was in every revenue act prior thereto and has been in every one since that act. In Section 42 of the Revenue Act of 1928, it is provided that "The amount of all items of gross income shall be included in the gross income for the taxable year in which *received* by the taxpayer * * *." (Italics ours.) How then can it be said that petitioner realized any gain in 1930 by reason of the Continental stock when the admitted facts show he did not receive the stock in 1930? See *Avery v. Commissioner*, 292 U. S. 210, 78 L. ed. 1216 (1934); *Lyle H. Olson*, 24 B. T. A. 702, 709 (1931); *Leroy G. Evans*, 5 B. T. A. 808 (1926); and *Roscoe H. Aldrich*, 3 B. T. A. 911 (1926).

2. The decision of the court below is in conflict with the decision of this Court in the leading case of *Helvering v. Tex-Penn Oil Company*, 300 U. S. 481 (1937), affirming the Third Circuit Court of Appeals, 83 F. (2) 518 (1936), which in turn reversed the Board of Tax Appeals, 28 B. T. A. 917. In that case this Court had squarely before it the question of the effect of a restrictive agreement on the value of corporate stock. In holding that under such circumstances stock has no value, this Court said:

"The court is also of opinion that the judgments must be affirmed upon the ground that in the peculiar circumstances of this case, the shares of Transcontinental stock, regard being had to their highly speculative quality and to the terms of a restrictive agreement making a sale thereof impos-

sible, did not have a fair market value, capable of being ascertained with reasonable certainty, when they were acquired by the taxpayers.

"In the absence of such value, the ownership of the shares did not lay the basis for the computation of a gain at the time they were received, or for a tax as of that date under the applicable statute."

Judge Maris, speaking for the Circuit Court in the present case, attempted to distinguish the *Tex-Penn* case on the grounds that the stock involved in that case was speculative and there was no evidence in the present case that the stock of Continental Roll & Steel Foundry Company was speculative. By thus laying the emphasis on the speculative feature of the stock in the *Tex-Penn* case and considering the restrictive agreement as only an incidental feature of the decision of this Court, the Circuit Court has misconstrued and distorted the decision of this Court. It is true that the stock in the *Tex-Penn* case was highly speculative but even stocks of that character have some market value. Thus the restrictive agreement in that case was the determining factor which brought about the result reached.

In its opinion the Circuit Court said (R. 147-148):

"We do not think that the *Tex-Penn* case requires us to hold that a mere restriction against sale for one year, without more, as a matter of law deprives stock of all market value."

The decision of this Court does require such a holding and other courts have adhered to the principle: *Propper v. Commissioner*, 89 F. (2) 617 (C. C. A. 2); *Schuh Trading Co. v. Commissioner*, 95 F. (2) 404 (1938) (C. C. A. 7); *Davidson v Commissioner*, 91 F. (2) 516 (1937) (C. C. A. 5); *Morris D. Kopple v. Commissioner*, 35 B. T. A. 1056 (1937). See also *International Mortgage and Investment Corporation v. Commissioner*, 36 B. T. A. 187 (1937), wherein the Board held no taxable income was

realized upon the receipt of "blocked" German marks which could not be sold.

3. If the element of speculative value in *Helvering v. Tex-Penn Oil Company*, *supra*, was an important factor in the ultimate decision in that case, then this Court should hear this case and decide whether the existence of a restrictive covenant such as existed in the present case is alone sufficient to require a holding, as a matter of law, that the stock of Continental Roll & Steel Foundry Company has no fair market value. The question is an important one as it involves the administration of the federal law embodied in the various revenue acts. It is not a novel one but rather one which has come to the attention of the courts on several occasions. It is the position of petitioner that the *Tex-Penn* case did decide the question, but if it did not, then this Court as the final arbiter of disputes arising under federal law should, in the interests of certainty and harmony in the administration of that law, hear and decide this case.

4. The decision of the Circuit Court in this case is directly contrary to the decision of the Circuit Court of Appeals for the Seventh Circuit in *Schuh Trading Co. v. Commissioner*, *supra*. That case involved a restriction on the right to sell the stock involved in many ways quite similar to the one in the present case, particularly in that each restriction was limited to one year. In holding that stock under such circumstances had no market value, the Seventh Circuit Court of Appeals said (411):

"And we have the further fact that the stock was not salable because of the restriction. If it was not salable, there was no market for it. There was, therefore, no market value until the restriction should be removed."

This case represents a clear and unequivocal holding that a restrictive agreement alone requires a finding that the stock has no fair market value.

The conflict is conceded in the opinion (R. 148) :

"In so far as the Schuh Trading Co. case may be considered as authority for plaintiff's position we find ourselves unable to follow it, for the reasons already stated."

5. The Circuit Court abused its discretion in overruling the specific finding of fact of the District Court that "The stock received by plaintiff by virtue of the restriction as to the sale thereof had no fair market value during the year 1930 and no fair market value thereof could be determined" (R. 126). It is a familiar rule of law that facts found by the District Court are conclusive if there is any evidence to support them. *Fleischmann v. United States* (1926), 270 U. S. 349, 355, 46 S. Ct. 284, 70 L. Ed. 624; *Eastman Kodak Co. v. Gray* (1934), 292 U. S. 332, 336, 54 S. Ct. 722, 78 L. Ed. 1291; *United States v. Bertelsen & Petersen E. Co.* (C. C. A. 1), 95 F. (2d) 867; *United States v. Jefferson Elec. Mfg. Co.* (1934), 291 U. S. 386, 407, 54 S. Ct. 443, 78 L. Ed. 859; *Indianapolis Glove Co. v. United States* (C. C. A. 7), 96 F. (2d) 816. In the present case there is evidence to support the finding of the District Court, and the finding of fact by the District Court was absolutely ignored by the Circuit Court.

The question is not whether the Continental Roll & Steel Foundry Company stock had any substantial value, but whether it had any fair market value. Substantial value is not sufficient upon which to compute gain: *Burnet v. Logan*, 283 U. S. 404 (1931); *Heiner v. Crosby*, 24 F. (2) 191 (C. C. A. 3, 1928); *Clarke v. Welch*, 46 F. (2) 563 (S. D. Cal. 1930). That this stock may have had some substantial value is conceded, but under the facts it had no fair market value in June, 1930, nor did it have any realizable value at that time, because it could not be sold, assigned or otherwise transferred until a year after

that time. The common stock could not even be used as collateral.

The Circuit Court states that there was no evidence of any speculative value. This conclusion is not supported by the record. The stock could not be sold for a year. Thus any potential purchaser in June, 1930, would have had to *speculate* as to what the market value would be in June, 1931. This Court well knows how the market value of a security can vary in a period of a year so that it appears clear that the value of petitioner's stock was highly speculative while it was still subject to the restrictive covenant. Further, the enterprise was a new one; the mere fact that the component corporations may have been successful affords no assurance whatsoever that the consolidated enterprise would prove to be the success its sponsors hoped it would be. For a complete history of this consolidation which was tainted with misrepresentation and failure to disclose on the part of the promoters, see Memo. Op. of the Board of Tax Appeals in *Donald C. Bakewell et al. v. Commissioner*, Docket Nos. 71029, 71160 and 72978, Commerce Clearing House Dec. No. 8959-C.¹

¹ In this case the Board said:

"Furthermore, the evidence discloses that the subscribers were not fully aware of all the material facts pertaining to the reorganization. The original plan of reorganization, together with a tentative balance sheet showing the financial set-up of Continental, approved by the Duquesne stockholders on May 12, 1930, did not include Hubbard, although it did authorize the bankers to negotiate with other corporations and include them in the consolidation under substantially similar plans. The plan submitted to Duquesne provided that, with the exception of ordinary dividends, no dividends should be paid on the capital stock after December 31, 1929, and that there should be no undisclosed liabilities. The Duquesne stockholders did not know that Hubbard was permitted to borrow over \$1,900,000 on June 13th and immediately declare a dividend to its stockholders of \$2,500,000. Neither were they aware of the fact that Wheeling had some undisclosed liabilities contrary to the plan, and was in such bad financial condition that without the reorganization it might have faced a receivership within from 90 to 120 days."

Petition.

There is, therefore, credible evidence upon which the District Court was justified in making its finding of fact that the stock had no fair market value. The holding of the Circuit Court that it did have value represents the adoption by that court of a function, namely, to decide questions of fact, which is not within its prerogatives.

Conclusion.

WHEREFORE, it is respectfully submitted that this petition for a writ of certiorari should be granted.

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November 16, 1940.
